No. 8429

IN THE

United States

Circuit Court of Appeals

FOR THE NINTH CIRCUIT. /3

FEDERAL HOUSING ADMINISTRATOR, on Behalf of the United States of America,

Appellant,

vs.

WM. H. MOORE, Jr., as Trustee in Bankruptcy of the Estate of PIONEER AUTO LAUNDRY, a Corporation, Bankrupt,

Appellee.

Appellant's Reply Brief

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SUBJECT INDEX

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ARGUMENT

The United States Has a Provable Claim Under Its Own Name

The Appellee states that the applicable subdivision of Section 63 (a) of the *Bankruptcy Act* in so far as material in this case is covered by subdivision (1) of that section.

While it is not conceded that the United States does not have a provable claim as against the assets of the

bankrupt corporation under subdivision (1) of Section 63 (a) of the *Bankruptcy Act,* it is submitted that subdivision (4) of Section 63 (a) of the *Bankruptcy Act,* Title 11 *U. S. C. A.* 103 (a) (4) definitely covers the facts of this case. That subdivision reads as follows:

> "Debts of the bankrupt may be proved and allowed against his estate which are * * * (4) founded upon an open account, or upon a contract express or implied."

The Pioneer Auto Laundry, hereinafter referred to as the bankrupt corporation, executed the note to the Seaboard National Bank under the terms of the National Housing Act, Title I thereof, as set forth in Title 12 *U. S. C. A.,* Secs. 1702 to 1706 (a), inclusive. The bankrupt corporation made its application for a Modernization Loan under this Act and the note was made pursuant to the application and expressly stated it was for a Modernization Loan. The note and loan were therefore from the date of execution subject to the provisions of Title I of the National Housing Act. Under the provisions of the Act a definite relation was therefore created between the United States and the bankrupt corporation upon the execution of the note and the report by the lending agency within 31 days thereafter under Regulations 12 and 13 of the Federal Housing Administrator for institutions operating under Title I of the National Housing Act; the United States insured, through the Federal Housing Administrator, the payee of the note, the Seaboard National Bank, against the default by the bankrupt corporation,—in effect, the United States became liable as an

indorser or guarantor of the note. At the time of filing of bankruptcy by the bankrupt corporation, the bankrupt corporation was liable upon a contract to the United States through the Federal Housing Administrator, in a sum certain, that is, in accordance with the provisions of the note and applicable provisions of Title I of the National Housing Act.

> An indorser of a note of a person who subsequently becomes bankrupt and is in default upon the note, may prove his claim in bankruptcy against the defaulting principal after payment of the note to the payee by the indorser and even if the payment was made subsequent to the filing of the petition in bankruptcy; and the claim may be proved in the name of the indorser.
>
> *Moch v. Market Street Natl. Bank,* 107 Fed. 897 (C. C. A. 3d Ct.), cited and approved in *Colman Co. v. Withoft,* 195 Fed. 250, 253 (C. C. A. 9th Circuit);
>
> *In re Salvator Brewing Co.,* 193 Fed. 989 (C. C. A. 2nd Circuit).

Therefore, the argument of Appellee that the Seaboard National Bank was the only rightful claimant in bankruptcy proceedings against the assets of the bankrupt corporation at the time of filing the petition in bankruptcy herein, is of no avail.

Appellee goes to some length in his attempt to prove that under the bankruptcy law the priority "is attached to the debt and not to the person of the creditor; to the claim and not to the claimant." This statement of the law is obviously incorrect when applied to the claim of

the United States. The cases cited by Appellant in its opening brief substantiate this position.

That there is no public policy against giving the United States a preferred claim as to moneys paid by the United States under the National Housing Act upon an insured loan where the borrower has already filed a petition in bankruptcy and is in default upon the loan, was at an early date in substance affirmed by the Supreme Court in the case of *United States v. State Bank of North Carolina,* 6 Peters 29, 38, wherein it is stated:

> "No reason can be perceived, why, in cases of a deficiency of assets of deceased persons, the legislature should make a distinction between bonds which should be payable at the time of their decease, and bonds which should become payable afterwards."

The purpose of the enactment of the Federal Housing Administration Act was to make ample credit available. If the contention of Appellee that the United States has no preferred claim in its own name in the bankruptcy proceedings herein, is sound, the very purpose and intent of the National Housing Act must fail. After receiving a report of default it would be the duty of the Federal Housing Administrator to ascertain whether or not the defaulting debtor is insolvent; and in case of insolvency it would be his duty to safeguard the funds of the United States and not to pay any of said funds to the creditor, in this case the Seaboard National Bank.

The United States Has a Preferred Claim

In Appellee's brief, under the heading "The Question of Sovereignty," the position is taken that even if the claim herein need not have been filed in the name of the Seaboard National Bank, there is no right to accord it a preferred status in the distribution of assets. The basis for Appellee's contention is that the claim is then a claim of the Federal Housing Administrator and not of the United States, and that the Federal Housing Administrator is a separate entity. There seems to be little merit to the position of the Appellee.

The Federal Housing Administrator is purely a Government official, appointed by the President by and with the consent of the Senate, under the provisions of the National Housing Act, 12 *U. S. C. A.* 1701, *et seq.* He is in no way comparable to a corporation provided by Federal law, such as the Emergency Fleet Corporation formed by the United States Shipping Board under the applicable acts of Congress, nor is he comparable to national banks formed under the laws of Congress. He is similar to all other officials of the United States.

While Section 1702 of Title 12 *U. S. C. A.* provides that:

> "The Administrator shall, in carrying out the provisions of this title and titles II and III, be authorized, in his official capacity, to sue and be sued in any court of competent jurisdiction, State or Federal,"

it is well to observe that he is suable only in his official capacity. The reason for making him amenable to suit in any court was the dissatisfaction expressed by financial

institutions with the original National Housing Act, which did not provide for suing the Federal Housing Administrator; the amendment was passed August 23, 1935, 49 Stat. 722.

Furthermore, subdivision (c) of Section 1703, Title 12 *U. S. C. A.,* provides that regulations prescribed by the Administrator must be approved by the Secretary of the Treasury.

Also, subdivision (a) of Sec. 1703, Title 12 *U.S.C.A.,* provides that the insurance by the Administrator of financial institutions may apply to loans and advances of credit "made by them on and after April 1, 1936, and prior to April 1, 1937, or such earlier date as the President may fix." The President, therefore, has the right to terminate the powers of the Federal Housing Administrator. That the money which is claimed herein is the money of the United States is established by the note and assignment and by the fact that collections by the Administrator upon notes resulting from insured loans under Title I of the National Housing Act are covered into the Treasury as "Miscellaneous Receipts" (letters of Comptroller General to Administrator, January 23, 1936). These miscellaneous receipts are covered into the general fund of the Treasury and are not available for withdrawal or expenditure by any agency of the Government without specific appropriation by the Congress.

The case of *North Dakota-Montana Wheat Growers' Ass'n v. United States,* 66 F. (2d) 573, 576, decided by the Circuit Court of Appeals for the Eighth Circuit in 1933, treats of a similar administrative Federal Agency,

the Federal Farm Board, declaring it to be a mere agency. At page 576, the Court states:

> "The situation as to the Farm Board is we think analogous to that of the United States Shipping Board. Both are mere agencies of the United States with no such distinct entity as is possessed by the stabilization corporations and the Fleet Corporation."

Surely the Federal Housing Administrator is no less a mere agent, and not in a class with a semi-public corporation; the Government of the United States has in no wise yielded control over the Administrator, and the rule of the *Bank of the United States v. Planters' Bank of Georgia*, 9 Wheaton 904, cited by Appellee, does not apply.

Authorities Cited by Appellee Do Not Oppose Appellant's Contention

None of the authorities cited by Appellee oppose Appellant's contention that the claim filed herein by the Federal Housing Administrator acting for and on behalf of the United States of America is a preferred claim requiring distribution to the United States in preference to general creditors from the assets of the bankrupt corporation. The cases cited which have to do with the United States Shipping Board Emergency Fleet Corporation, to-wit: *Sloan Shipyards Corp., et al. v. U. S. Shipping Board Emergency Fleet Corp'n, et al,* 258 U. S. 459, 42 Sup. Ct. 386; *In the Matter of the Eastern Shore Shipbuilding Corp'n, Bankrupt,* 274 Fed. 893, and *United*

States v. Wood, 290 Fed. 109 (cert. denied, 263 U. S. 680), are not applicable to a claim filed by the Federal Housing Administrator. The situation in this case is similar to the situation wherein a Collector of Internal Revenue files a claim for and on behalf of the United States. The claim itself recites that it "is a claim of the United States of America." The Shipping Board Emergency Fleet Corporation was a corporation authorized by the laws of Congress to be formed under the laws of the District of Columbia like any private corporation, in which private individuals might hold stock; furthermore, at the time of the decision of the Supreme Court in the case of *Sloan Shipyards Corp., et al. vs. United States Shipping Board Emergency Fleet Corp., et al, supra,* and its allied cases discussed by Appellee, the bankruptcy law, Section 64 (a) and Section 64 (b), provided, as interpreted by the Supreme Court in the case of *Davis v. Pringle,* 268 U. S. 315 (which case approved the theory of the dissenting Justices in the case of *Sloan Shipyards Corp. v. U. S. Shipping Board Emergency Fleet Corp., et al, supra,* and held that the United States was not a "person" within the meaning of Section 64 of the *Bankruptcy Act*), that the United States had no priority in the distribution of the assets of a bankrupt except for unpaid taxes. The Supreme Court further expounded its theory as to claims of priority by instrumentalities of the United States under the bankruptcy law in the case of *Mellon v. Michigan Trust* (1926), 271 U. S. 236, 240, wherein, after pointing out that Section 10, *Act of March 21, 1918,* Chap. 25, 40 *Stat.* 451, 456, provides that the Director General of Railroads is forbidden by such Section to de-

fend in any suit against him as such operator upon the ground that he was an instrumentality or agency of the Federal Government, the Court states:

> "To permit the claimed preference, we think, would conflict with the spirit and broad purpose of the statute. These become plain enough upon consideration of the just ends which Congress had in view together with the recent policy, revealed by the Bankruptcy Act, in respect to priorities."

That the decisions in the *Sloan Shipyards* case, *supra; Davis v. Pringle, supra,* and *Mellon v. Michigan Trust, supra,* do not weigh against the preferred status of the claim filed by the Federal Housing Administrator on behalf of the United States, is supported by the decision of the Circuit Court of Appeals for the Second Circuit in the case of *United States v. Kaplan,* 74 F. (2d) 664. This case holds that the rule of *Davis v. Pringle, supra,* that claims of the United States had no preferential status for debts other than taxes because of the declared intent of Congress under the Bankruptcy Act to remove such preferential status, except as to taxes, no longer applies because of the specific amendment to the Bankruptcy Act, Section 64 (b), adopted by Congress in 1926 after the decision in *Davis v. Pringle,* supra, which amendment provides that the United States is a person within the meaning of Section 64 (b) (5) of the *Bankruptcy Act,* now Section 64 (b) (7).

Another recent case which has upheld the right of a claim made by an official of the United States in his official capacity to a priority status in bankruptcy pro-

ceedings is the case of *Barnett, State Bank Commissioner, v. American Surety Co., 77* Fed. (2d) 225, decided by the Circuit Court of Appeals for the Tenth Circuit in 1935. That was a case involving a claim made by an employee of the Department of Interior, a disbursing agent of individual Indian moneys held in trust by the United States, against the assets of an insolvent bank in which the funds had been deposited. The indebtedness was held an indebtedness to the United States within the meaning of Section 3466 R. S., 31 *U. S. C. A.* 191.

There seems no good reason why a claim by the Federal Housing Administrator for the United States should not have the same priority.

The United States is Acting in Sovereign Capacity Under National Housing Act

The Appellee contends that when the United States enters into private business, it should be allowed no such rights as priority rights in bankruptcy. However, under the National Housing Act the Government has exercised its powers of sovereignty and has not yielded control in any way of the instrumentality. The United States under the National Housing Act has extended aid to business and credit of the country just as it did to agriculture under the Agricultural Marketing Act. The Circuit Court of Appeals for the Eighth Circuit, in the case of *North Dakota-Montana Wheat Growers' Ass'n v. United States, supra,* in discussing the latter act, stated at page 578:

> "It could not be successfully claimed that the government in loaning money to assist the agricultural

development of the country and subsequently trying to collect it for the benefit of the national treasury has entered into private business or become a trading partner."

The reasoning is applicable to the National Housing Act.

There is therefore no public policy why a claim by the United States under the National Housing Act should not have priority in bankruptcy proceedings, and no reason to believe Congress did not so intend.

Conclusion

In conclusion it may be stated that the argument of Appellee concerning future possible activities of the Federal Government in the event Appellant is sustained, and to the effect that to give the United States a priority in this case would work an injustice, seems to be of no materiality in the light of the many decisions which have announced that the priority is given the United States to protect the public credit, and the recently declared policy of Congress in the 1926 amendment to the Bankruptcy Act. This is not a case of the Government acting in a private capacity, but is a case of an exercise of sovereign power through a government agent over which Congress has retained control; an agent who has no inherent power to sue and be sued; whose powers are confined to those given by the statute creating it, except as Congress increases or decreases those powers from time to time; who possesses no funds of its own and who must immediately turn over to the United States Treasury any moneys collected.

It is a case of a claim made by the United States for a debt due upon a contract from the bankrupt corporation at the date of the filing in bankruptcy; and under the Bankruptcy Law construed with Section 3466 R. S., the claim is entitled to a preferred status.

Respectfully submitted,

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